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July 18, 1996

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Ex Parte

Mr. William F. Caton
Acting Secretary
1919 M Street, NW, Room 222
Washington, D.C. 20554

Re: Ex Parte C(Docket No. 96-112, Allocation of Costs Associated with LEC Provision (f Video Programming Services

Dear Mr. Caton:

Yesterday, T. Seaton, L. Darby and the undersigned, representing BellSouth, met with A. Wallgren, Legal Advisor to Co nmissioner Ness to discuss BellSouth's position regarding the above-referenced proceeding. he attached documents represent the basis for the presentation and discussion an(are consistent with BellSouth's position in this proceeding.

Pursuant to Section 1.1206(a)( ) of the Commission's rules, two (2) copies of this notice are being filed with the Secretary (f the FCC. Due to the lateness of this meeting this filing is being made the day after the m eting.

Sincerely,

Maurice P. Talbot, Jr.

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Executive Director - Federal R egulatory

Attachments

cc: A. Wallgren

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Overview of Financial Regulation

The Relationship of Accounting, Separations, Access Charge, Rate of Return, and Tariff Rules

Role:

Part 32: Establishes accounting practices, account structure, affiliate transaction rules.

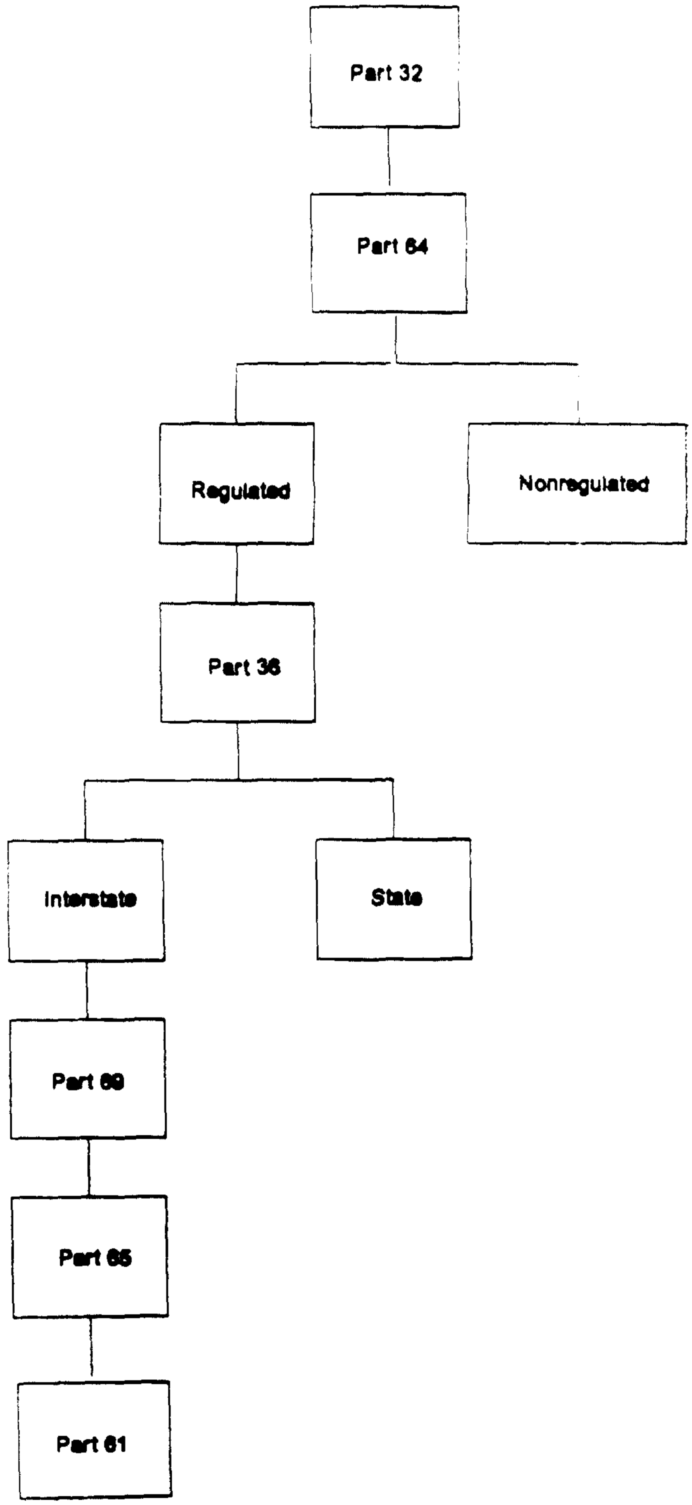
Part 64: Rules for allocation of costs between nonregulated/regulated operations

Part 36: Jurisdictional separations procedures

Part 69: Defines access elements, apportionment of interstate costs to access elements, some rate parameters

Part 65: Rate of return procedures, rate base/net income (revenue requirement) rules

Part 61: Tariff filing requirements



BELLSOUTH

EX PARTE MEETING

VIDEO PROGRAMMING SERVICES
CC DOCKET NO. 96-112

JULY 17, 1996

Summary and Conclusions

Record is insufficient to judge impact on investment and video competition
- No market model; no theory of investment and regulation
- Insufficient data to evaluate impact of investment and innovation
- Old investment models not applicable

Minimal carrier incentive/opportunity to practice "predatory" cross-subsidy
Guarding against cross-subsidy through cost allocations may reduce investment
Consumers' interests extend to both telco and cable services market
Commission can increasingly rely on competitive markets to protect the public

1. Commission must balance several goals under the new law
   - Promote competition
   - Encourage investment and innovation
   - Increase consumer choice
   - Reduce regulatory intrusion

   - Assure just and reasonable rates for regulated services

2. Commission goals (NPRM paras. 22 and 24)
   - Comply with Act's provisions to:
     - facilitate offer of competitive telecom services
     - promote telco entry into video distribution and program services markets

     - ensure just and reasonable rates
       - administrative simplicity
       - adaptability to technological change
       - uniform application
       - consistency with economic principles of cost causation

   - New goals and new public interest definition requires
     - explicit statement of goals and weights

3. Conclusions respecting cost allocation
   - Cost causation not estimable or verifiable
   - Common cost allocations:
     - are completely arbitrary, but
     - are implicitly purposive
     - will have substantial impact on other statutory goals
       - investment and innovation
       - competition, consumer choice and program diversity

4. Threat of cross-subsidy increasingly remote
   - Regulatory protections against cross-subsidy are unnecessary
   - Price caps eliminate regulatory incentives to practice uneconomic cost-shifting
   - Implementation of 1996 Act will eliminate residual opportunities
   - Cross-subsidy detracts from shareholder value in present environment
   - If used to reduce rates, regulatory allocations may well:

reduce telco investment incentives; reduce broadband innovations
reduce competition in video services; reduce diversity and choice

5. Record not complete with respect to investment implications of proposals
   - No connection between regulation and investment incentives/opportunities
   - No models, no data, no theory, basis for assessing impact on
     - video competition
     - consumer alternatives
     - investment and innovation
   - Parties cannot verify Commission analysis with models and data

6. Economic welfare in this proceeding is complex
   - Consumers have stake in development of all markets
     - Telephone services
     - Video services
     - Other digital and data applications
   - Interests of telephone "ratepayers"
     - extends to all services
     - has both short and long run dimensions
   - Economic welfare not advanced by protecting ratepayers, if
     - rate of investment and innovation is diminished
     - competition to cable systems is diminished
     - consumers have fewer options

7. Cost allocation as regulatory tool is nearly obsolete and certainly risky
   - Only markets can "efficiently" allocate common costs
   - Market allocations cannot be prospectively emulated by regulators
   - Incorporation of regulatory errors in rates will lead to
     - resource misallocation
     - reduction in investment
     - reduction in benefits from competition in video market
     - fewer options, lower quality, higher prices for unregulated services

8. The A-J-W model of predatory cross-subsidy no longer applies
   - No rate of return constraint; or, evidence that earnings exceed cost of capital
   - Decoupling of prices and costs under price caps:
     - eliminates incentives to burden users of regulated services
     - assures shareholders are penalized for excess costs/wasteful investment
   - Historically regulated markets are increasingly "contestable" (Viz., Dkt. 96-98)
   - Losses in one market cannot be recovered in other markets now, or in the future
   - Predatory cross-subsidy cannot be defended to shareholders
   - No evidence that shareholder value is created by predatory cross-subsidy

9. Markets assure that regulated services users will benefit from economies of scope
   - Consumers have diverse interests
     - Price, quality, diversity
     - Current and future concerns
     - Consumers:
       - are multiservice users -- voice, video and data
       - have a stake in development of diversified networks
       - may not be served by narrow policies focused on voice

10. Exogenous treatment under price caps of carrier investment arbitrarily allocated:
- Is inconsistent with past practice and policies
- Is inconsistent with the clear statutory mandate
- Will penalize shareholders for investing in dual purpose plant
- Will discourage competition, investment and deny consumer options
- Will be a factor in carriers' broadband investment decisions

11. To identify public interest in this proceeding, the Commission should
- Consider current investment incentives/abilities of telcos and cable
- Develop models to determine impact of costing alternatives on those incentives
- Perform analyses of differential policy impacts on policy goals
  - competition in video services
  - investment in broadband networks
  - diversity and quality of consumer broadband options
  - consumers broad interests in network services and as voice users

12. There is no basis in fact or theory for the NCTA fixed allocation proposal

13. Commission may make two kinds of errors with different impacts
- Type I Error -- Regulate costing when it is not needed
- Type II Error -- Fail to regulate costing when it is needed
- Unnecessary and misconceived costing will have serious impacts

14. New statutory goals, past regulatory reforms and emerging competitive market structures require new regulatory objectives, new models and new methods of analysis.